No. 7885.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

In the Matter of
HENRY E. SHERER,
Bankrupt.

V. W. Erickson, as Trustee in Bankruptcy of the Estate of Henry E. Sherer,
Appellant,

vs.

Friend W. Richardson, as Superintendent of Banks of the State of California, and in Charge of the Liquidation of the Bank of San Pedro, an Insolvent California State Banking Corporation,
Appellee.

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APPELLEE'S BRIEF.

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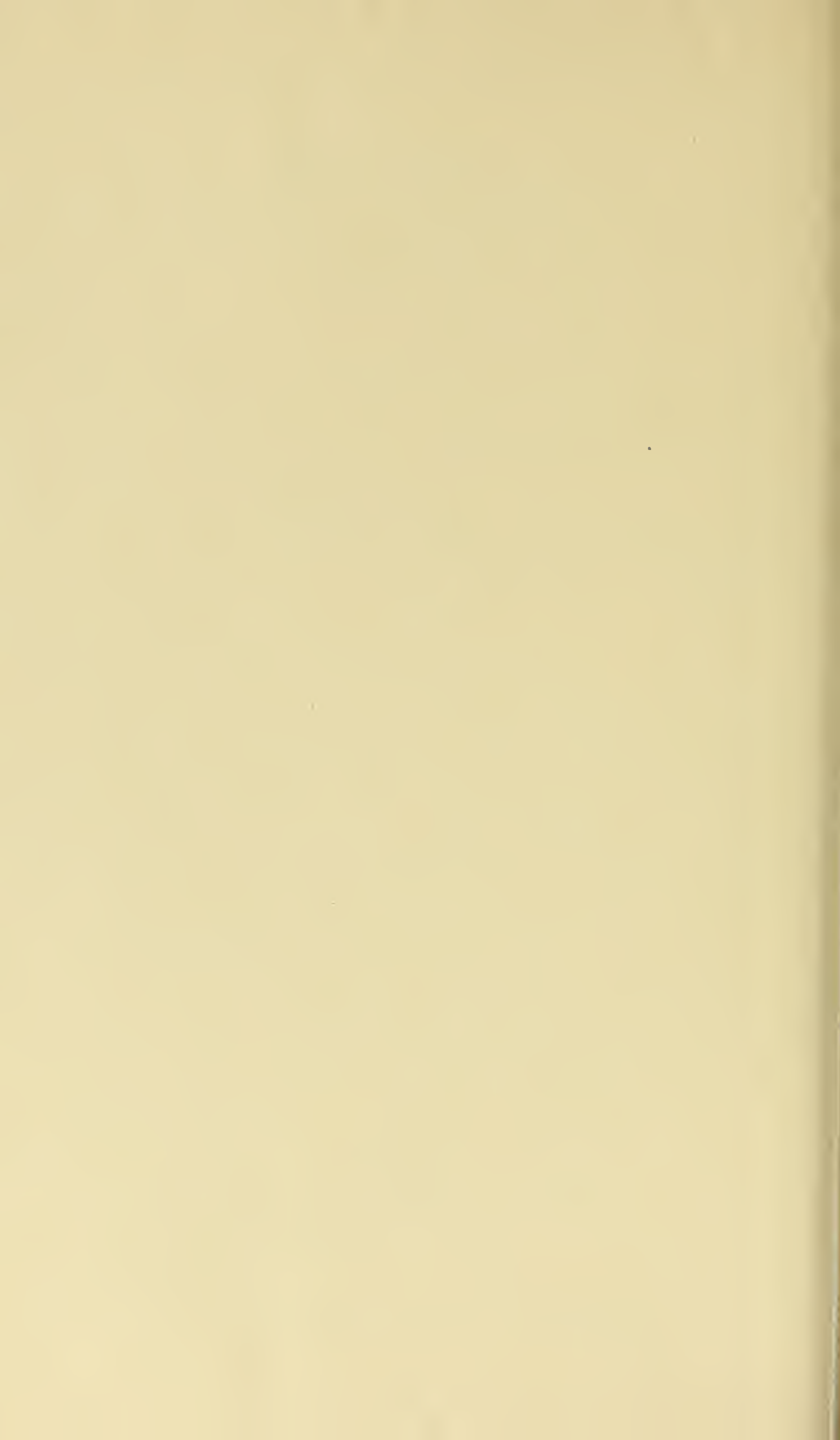

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APPELLEE'S BRIEF.

QUESTIONS PRESENTED.

The statement of the case and of the facts presented in Appellant's brief is a correct presentation of this controversy and from these facts and the proceedings had before

the Referee, and the judgment of the District Court, the following questions arise:

(a) Is the liability of a stockholder in a bank organized under the laws of the State of California founded upon a contract, express or implied, within the purview of Subdivision 4 of Section 63 of the Bankruptcy Act relating to provable debts?

(b) Is such liability a provable debt in bankruptcy when the stockholder (here the bankrupt) was adjudicated a bankrupt prior to the formal levy of the assessment upon the stockholders of a state bank by the Superintendent of Banks?

ARGUMENT.

I.

The Nature of Stockholders' Liability in a California State Bank Is Contractual Rather Than Statutory.

Act 652a, being an Act to define the liability of stockholders in California state banks and to provide for the enforcement and collection of that liability by the Superintendent of Banks, effective August 14, 1931 (Volume One, General Laws, p. 314), provides for an equal and ratable liability.

The Act further provides in substance that after the Superintendent of Banks shall have taken possession of the business and property of any bank, he may at any time during the process of such liquidation, if necessary to pay the debts of the bank, enforce this individual liability of the stockholders by calling for a ratable assessment upon the stockholders, without previous judicial ascertainment of the necessity therefor, and the action of the

Superintendent of Banks in calling for such assessment shall be conclusive on the stockholders of the necessity therefor: that the assessment shall be levied by order of the Superintendent of Banks, which order shall specify the amount of the assessment and shall fix a date on which the said assessment shall be due and payable, and on failure of the stockholder to pay the assessment in full upon the date specified in the order a right of action shall immediately accrue to the Superintendent of Banks to recover the amount of the assessment remaining unpaid and vesting upon the Superintendent of Banks power to maintain an action or actions to enforce and collect the assessment.

The wording of this Act is almost identical with the individual liability of stockholders in National Banking Associations, as that liability is embodied in Sections 64. 65 and 66, Title 12, U. S. C. A., pages 112, 145 and 150.

The existence and extent of the liability of the stockholder for assessments or contribution to the corporation for payment of the debts of the corporation is determined by the law of the state of incorporation (*American Law Institute*, Restatement of the Law on Conflict of Laws, Volume 1, pp. 185, 273), and in determining the validity of the claim against a bankrupt the law of the state where the case arose must control (*Heyward v. Goldsmith*, 269 Fed. 946), unless the bankruptcy law otherwise provides (*Bennett v. North Philadelphia Trust Co.*, 66 Pa. Sup. Ct. 261).

The Supreme Court of the State of California has, in a recent decision (*Kaysser v. McNaughton*, 91 Cal. Dec. 725, 731) held that Section 322 of the Civil Code of the State of California which heretofore contained a liability

of stockholders of California corporations, was repealed August 14, 1931, and that the stockholders' liability as it existed prior to that date did not arise out of any written evidence of the indebtedness executed by the corporation such as a promissory note, but that the liability arose by operation of law from the creation of the debt by the corporation and the liability was independent of the indebtedness, and that the liability heretofore imposed by said Section 322 of the Civil Code was not derivative or secondary, but primary and independent as that of a principal debtor, rather than of a surety, and on page 732 Justice Shenk states:

> "The relation between creditor and stockholder prior to August 14, 1931, was contractual."

citing a previous decision of the Supreme Court of the State of California, *Aronson & Co. v. Pearson,* 199 Cal. 286.

In the case of *Rainey v. Michel*, a companion decision written by Justice Shenk, reported in Volume 91, Cal. Dec. p. 732, the constitutionality of the above mentioned Stockholders' Liability Act of 1931 was upheld as applied to debts incurred subsequent to August 14, 1931.

No comment is made, nor does the case decide or touch upon, the nature of the liability created by the 1931 law. It is the Appellee's contention that this liability imposed upon stockholders of State Banks by the 1931 Act is no different in principle than the liability which is imposed

upon such stockholders by Section 322 of the Civil Code, except, of course, that the amount of liability is different, in that under the present law the liability is limited to an amount equal to the par value of the stock and is not a proportionate liability.

While it may be said that the 1931 law does not create a direct personal and primary obligation upon the stockholder that Section 322 of the Civil Code did, we believe that the liability as created by the new law is a direct, personal and primary obligation. Even if it should be contended by Appellant that the obligation under the new law does not arise upon the incurring of the obligation and can only come into existence upon the insolvency and suspension of the bank, followed by the order for the levy of the assessment by the Superintendent of Banks, it would not alter the situation in the present case, due to the fact that not only have the debts been incurred, but the bank has become insolvent. It has ceased to do business and has been taken into possession of the Superintendent of Banks, who was in charge thereof prior to the adjudication in bankruptcy, which is the date, as we see it, which controls and makes possible the application of the principles of law which we contend are applicable to this case.

The Bank of San Pedro, in which the bankrupt was a stockholder, closed its doors in March, 1933, and remained in conservatorship under the State Bank Act until December, 1934, at which time the Superintendent of Banks

took possession for liquidation purposes and, thereafter, on January 21, 1935, the above bankrupt filed in the above entitled proceeding his voluntary petition in bankruptcy, with schedules, and was thereupon adjudicated a bankrupt and his case referred to a referee. Several months after the adjudication an order was made by the Superintendent of Banks of the State of California levying an assessment upon the stockholders of the bank, and subsequently filed a claim in the above bankruptcy proceeding.

In view of the similarity between the California Stockholders' Liability Act, above referred to, and the National Bank Act, we believe that decisions of various Federal Courts on the point involved in this action should be helpful.

In the case of *Caldwell v. Morfa*, 24 Fed. (2d) 106, in which many of the former Federal decisions are quoted, it was stated as follows:

> "The liability of a stockholder in a Texas state bank upon a state statute, in almost the precise words of the United States statute, is such a 'debt' and 'demand' as would authorize an attachment, since it arises out of a contractual relation. Stringfellow v. Patterson (Tex. Civ. App.), 192 S. W. 555. See, also, Felker v. Doughlass (Tex. Civ. App.), 57 S. W. 323; Gould v. Baker, 12 Tex. Civ. App. 669, 35 S. W. 708; Chapman v. Thomas (Tex. Civ. App.), 283 S. W. 337.
>
> The defendant has filed a very able brief, and contends that an assessment made by the comptroller

under the authority of the statute is in the nature of a penalty, and does not arise from the stockholder's contract either express or implied, but I am of the opinion that the question is ruled against her, not only by the Texas cases under the Texas attachment statute, but likewise by the following United States holdings: Williams v. Travis (C. C. A.), 227 F. 134; Benton v. American National Bank of Macon (C. C. A.), 276 F. 368; Richmond v. Irons, 121 U. S. 270, 7 S. Ct. 788, 30 L. Ed. 864; Christopher v. Norvell, 201 U. S. 216, 26 S. Ct. 502, 50 L. Ed. 732, 5 Ann. Cas. 740; McDonald v. Thompson, 184 U. S. 71, 22 S. Ct. 297, 46 L. Ed. 437; Deweese v. Smith, *et al.* (C. C. A.), 106 F. 438, 66 L. R. A. 971."

In the case of *Deweese v. Smith, et al.,* 106 Fed. 438, at pages 441 and 442, it is stated:

"The liability of a shareholder of a national bank is contractual. It rests on his subscription for or his receipt and acceptance of his stock. By this act he agrees to be a shareholder of the bank, and to assume and discharge all the legal obligations and duties of such a shareholder. Bank v. Hawkins, 174 U. S. 365, 370, 19 Sup. Ct. 739, 43 L. Ed. 1007."

This decision was affirmed by the Supreme Court of the United States in the case of *Smith v. Brown* (1902), 187 U. S. 637, 23 S. Ct. 845, 47 L. Ed. 344.

In Massachusetts and New York we find decisions holding that the liability arising out of an assessment against a stockholder is a claim provable in bankruptcy within Section 63a-4 of the Bankruptcy Act.

> *Van Tuyl v. Schwab* (1916), 161 N. Y. S. 323, 174 App. Div. 665, affirmed (1917) 116 N. E. 1081, 220 N. Y. 661;
>
> *Broderick v. Britting* (Sup. 1933), 264 N. Y. S. 8, 147 Miscellaneous Reports 363;
>
> *Cunningham v. The Commissioner of Banks* (1924), 249 Mass. 401, 144 N. E. 447.

In the case of Williams v. Travis, 277 Fed. 134, at page 136, it is stated:

> "The liability of stockholders of national banks, provided for by statute (38 Stat. 273, g23 (Comp. St. g9689)) is contractual. Matteson v. Dent, 176 U. S. 521, 20 Sup. Ct. 419, 44 L. Ed. 571; Christopher v. Norvell, 201 U. S. 216, 26 Sup. Ct. 502, 50 L. Ed. 732, 5 Ann. Cas. 740; Benton v. American National Bank (U. S. Circuit Court of Appeals, 5th Circuit), 276 Fed. 368. Expressions used in the opinion in the case of McClaine v. Rankin, 197 U. S. 154, 25 Sup. Ct. 410, 49 L. Ed. 702, 3 Ann. Cas. 500 are relied on by counsel for the appellees to support the contention that the liability of Travis as a stockholder of the failed Bank was not, when the attacked transfers were made, a debt or demand within the meaning of the Florida Statute of Frauds declaring every feoffment, gift, grant, etc., made or executed * * * to the end, purpose or intent to

delay, hinder or defraud creditors or others of their just and lawful actions, suits, debts, etc., to be utterly void as against those so intended to be delayed, hindered or defrauded. Revised General Statutes of Florida, g3864. The question whether the liability of a stockholder of a failed national bank is a debt or demand within the meaning of the statute of frauds was not involved in that case.

"It was decided in that case that the provisions of the Washington statute of limitations applicable to a suit brought by a receiver of a national bank to enforce an assessment against stockholders was the one which provided that 'an action for relief not herein before provided for shall be commenced within two years after the cause of action shall have accrued' " . . . "We do not think that anything said in that opinion supports the above-mentioned contention of counsel for the appellees."

and at page 137:

"There was no indication of an intention to depart from or modify the ruling in Matteson v. Dent. The liability of Travis was fixed on the failure of the bank before the attacked transfers were made. Peters v. Bain, 133 U. S. 670, 10 Sup. Ct. 354, 33 L. Ed. 696. That liability, though it is the creature of the statute, is contractual, because it cannot attach without the consent of the party made subject to it . . ."

We believe these authorities establish that even though the liability of a stockholder in a bank was changed in 1931, it still remains contractual in nature.

II.

The Claimant Does Have a Provable Claim Under the Terms of the Bankruptcy Act, as It Is Not Conditional or Contingent and Is, Therefore, Provable.

Subdivision 4 of Section 63 of the Bankruptcy Act, in defining provable debts and in providing that debts of a bankrupt may be proved and allowed against his estate, sets forth that, among other things, provable debts are those "founded upon an open account *or upon a contract express or implied*". The same section of the Bankruptcy Act likewise provides that unliquidated claims against the bankrupt may be liquidated in such manner as the Court shall direct and may thereafter be provided and allowed against the estate. This last provision, of course, has reference only to debts which are not liquidated at the time the claim is originally filed. One of the earliest decisions, and in fact so far as we have been able to find the earliest one, on the provability, under the Bankruptcy Act, of a stockholder's liability is that written by Judge Remington, himself a Referee in Bankruptcy and the author of that splendid text on the law of bankruptcy which bears his name, which decision may be found reported in *In re Rouse*, 1 American Bankruptcy Reports (Fed.) 393, 40 Ohio L. J. 220. When this opinion was written by Judge Remington in 1898, he had little or no precedent from which to draw his conclusions. His opinion is a lengthy and exhaustive one consisting, as it does, of an analysis of many decisions based upon facts analogous to those before him. He definitely laid down the rule, which has since been followed by the Federal and State Courts, that the liability of a stockholder in a corporation was a contractual obligation, being founded upon an implied

contract, and as such was a provable debt within the meaning of the Bankruptcy Act. In the cases before Judge Remington there was no provision in the law whereby a speedy determination might be made as to the amount of the stockholder's liability. In the instant case the assessment was levied by the Superintendent of Banks and it was determined by him that a one hundred per cent assessment was necessary in order to pay the debts of the insolvent Bank. This determination by the Superintendent of Banks was officially promulgated within two weeks after the bankruptcy adjudication. However, the State Bank Act does not provide that a stockholder in a state bank shall be liable if and when the Superintendent of Banks makes an assessment. As heretofore stated, the liability is direct, personal and primary. When the Superintendent of Banks of a state bank seeks to collect a stockholder's assessment, he acts as the representative of the creditors and enforces a contractual obligation voluntarily assumed by such stockholder when he acquired his stock and thereafter debts were incurred which remained unpaid at the time of the insolvency of the bank. The Superintendent of Banks, therefore, is, with respect to the collection of a stockholder's liability, merely the agent of the creditors of the bank.

Appellant objects to the allowance of the claim in the instant case because the Superintendent of Banks had not levied the assessment until shortly subsequent to the adjudication in bankruptcy. However, we believe the Trustee overlooks the fact that the liability of the stockholder in a state bank does not arise, become fixed or mature by reason of any act or lack of action on the part of the Superintendent of Banks. The liability as it comes into existence is fixed and matures by reason of

the terms of the statute itself. The necessity for, and method of collection of, the debt owed by the stockholders, that is, the enforcement of the liability, is charged to the Superintendent of Banks, but the Act does not place upon him the authority to fix the liability. The Act determines and fixes the liability and the Superintendent of Banks carries it into effect.

The authorities, we believe, are uniform, and we refer to the annotator's notes on the subject found in 62 A. L. R. p. 997, that a stockholder's liability is sufficiently definite and fixed to enable it to be barred by his discharge in bankruptcy where the corporation at the time of his bankruptcy proceedings is insolvent and in bankruptcy, or in the hands of a receiver, or in the process of liquidation or winding up. This rule is based upon the fact that in such a case all the events from which the demand arose have actually happened and all the facts necessary to ascertain the stockholder's proportion and amount of the sum to be contributed were extant and capable of strict proof. It may be suggested that the exact amount of the bankrupt's liability could not be determined until the Comptroller had made an assessment. Conceding this to be true, it does not alter the controlling principle of law.

As stated by Judge Remington in his first decision hereinbefore referred to:

> "I can see easily that in many cases the bankruptcy court will direct the claimant, after he has filed his proof of debt, to proceed to liquidate the claim in a stockholder's liability suit before admitting the same to proof, or allowing it. But I can also understand how, in some cases, where the facts are all admitted, and are all simple and not complicated, the court will itself make the computation. This I believe is the

> only question. Complicated questions are likely to arise concerning the proof of almost any claim—some, no doubt, quite as puzzling and as intricate as that of determining some cases of stockholder's liability; but a difficulty in determining the proper amount can in no way disentitle a claim from having an attempt made to determine it."

In the case at bar, we are not concerned with the necessity of having the amount of liability adjudicated for the amount has become liquidated by the action of the Superintendent of Banks in levying an assessment for the definite amount stated within a short time after the bankruptcy adjudication and a long time before the time expired for filing claims.

Even though there had been no provision in the State Bank Act authorizing the Superintendent of Banks to determine the necessity of an assessment and to collect it, it would not affect the provability of this claim, because the court could have referred the matter to some tribunal of competent jurisdiction for determination, and, in fact, with respect to the liability of stockholders in ordinary corporations, this has been repeatedly done by bankruptcy courts.

In the case of *Burke v. Maze*, 10 Cal. App. 207, the old California stockholder's liability law was held to be a provable claim in bankruptcy. In this case the bank had become insolvent and was in liquidation prior to the adjudication in bankruptcy of the stockholder. No claim was filed by the bank, or its receiver, against the bankrupt's estate, but after his discharge an action was brought upon the stockholder's liability and the stockholder set up as a defense his discharge in bankruptcy.

In holding the liability had been discharged, the court stated as follows:

> "A discharge in bankruptcy releases the bankrupt from all his provable debts (with certain exceptions, of which this is not one). (Bankruptcy Act, 1898, Sec. 17 (30 Stats. at Large, 550; U. S. Comp. Stats. 1901, p. 3428).) The said act further provides (Section 63): 'Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability . . . as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not . . . (4) Founded upon an open account or upon a contract, express or implied.' As the bank had become insolvent the directors or receiver, as the case may have been, could have proven the claim of the bank against the defendant. The court of bankruptcy could have heard proof, if necessary, as to the amount of the debts of the bank and the value of its assets. In other words, it could readily have determined as to whether or not it was necessary to collect the amount for which defendant was liable to the bank in order to pay the creditors. The bank was insolvent, and it is manifest that it was the duty of the directors to collect the unpaid subscriptions. The defendant was liable. His liability was founded upon his subscription or ownership of the certificates of stock, on which ten per cent yet remained unpaid, and upon the existence of creditors and debts of the bank requiring the payment of the subscription in order to satisfy them. It is true that before the obligation or liability of the defendant became fixed so as to permit the bringing of a suit against him there must have been a call for the amount; but we must presume that the corporation, even if insolvent, intended to follow the law and per-

form its duty. If it did not do so, the power of the court, as a court of equity, could have been invoked by the creditors, and means would have been found to collect the unpaid amount so due by defendant. It therefore logically follows that if defendant had assets, such assets went into the hands of the trustee in bankruptcy, and the directors of the bank could have proven the claim against the defendant, and received the dividend that might have been paid through the bankruptcy court. It makes no difference whether the bankrupt had assets subject to the claim of his creditors, as the principle is the same. The debt of the defendant existed; it was provable in the bankruptcy proceedings.

The following authorities sustain the views herein expressed: Iron v. Manufacturers' National Bank, 27 Fed. 591; Carey v. Mayer, 79 Fed. 926, (25 C. C. A. 239); Glenn v. Abel, 39 Fed. 10; In re Smith, 146 Fed. 923.

Counsel for respondent call our attention to several cases which apparently hold to the contrary. Most of these cases arose where there was no question as to the insolvency of the corporation. But if any of them hold that in case the corporation had become insolvent at the time of the filing of the petition in bankruptcy the claim for an unpaid subscription could not have been proven, we cannot follow them.

In Purdy's Beach on Private Corporations, volume 1, section 332, after discussing the rule contended for by plaintiff as to the bankruptcy of shareholders with unpaid subscriptions, the author says: 'If, however, the company is in liquidation at the time of his bankruptcy, the estimated amount of future calls may be proved.' See the authorities cited in note 15 to the above section."

Other cases to the same effect are:

Van Tuyle v. Schwab, 161 N. Y. Supplement, 323;

7 Corp. Juris, 293;

American Tile v. Garrett, 110 U. S. 228, 20 L. Ed. 149, 4 Sup. Ct. 90;

In re Walker, 64 Fed. 680.

This Court, in the last mentioned case, determined that the creditors of a corporation in which an alleged bankrupt was a stockholder held a provable claim against the stockholder, an alleged bankrupt, so as to entitle them to act as petitioning creditors.

So, we submit that the right of the Superintendent of Banks to share in the estate of this bankrupt depends upon the status of his claim at the time of the filing of the petition in bankruptcy, and if the debt is not a provable one at that time within the meaning of that term, as used in the Bankruptcy Act, it, of course, cannot be proved, but it is not essential to the right to prove this claim that it should have existed prior to that time. If there was a liability of the bankrupt existing upon the stockholders at the time when the petition was filed, although it had not become fixed or the amount thereof ascertained at that time, a claim based thereon may be proved if the liability becomes fixed and certain within the time allowed for filing claims.

In re James Dunlap Carpet Co., 163 Fed. 541, 20 American Bankruptcy Reports, 882.

In the instant case there was a liability existing when the petition was filed and the amount of that liability has since become fixed.

III.

Answering Appellant's Contentions.

The case of *Zavelo v. Reeves,* 227 U. S. 625, 57 L. Ed. 676, cited and quoted on page 8 of Appellant's Brief, supports a rule which cannot properly be applied in the present case, for the reason that it holds that a loan to the bankrupt to effect a compromise in bankruptcy and a new agreement made after the adjudication by the bankrupt to pay a claim filed in bankruptcy was not a provable debt. The issue involved was entirely confined to the question whether or not a provable debt filed in the bankruptcy matter and revived by a new promise was discharged in bankruptcy. It was obviously within the exception provided by the Bankruptcy Act, and upon being revived, could not be a provable debt so as to be dischargeable since the new promise was not made until after the adjudication.

Doubt whether a debt is provable, or whether it is an unliquidated demand which may be made provable, should be resolved in favor of its provability.

> 7 *Corp. Juris*, Par. 468, p. 291;
>
> *Dycus v. Brown*, 135 Ky. 140, 121 S. W. 1010, 28 L. R. A. (N. S.) 190.

The cases of *Page v. Jones,* 7 Fed. 541, *Armstrong v. McAdams*, 46 Fed. 932 and *McClaine v. Rankin*, 197 U. S. 154, cited in Appellant's Brief, do not settle questions which have arisen in bankruptcy proceedings; in fact, these decisions concern themselves with an interpretation of attachment, garnishment or limitation of action statutes.

It is to be remembered that it is possible, both under the National Bank Act and California Bank Act (Sec-

tion 133, Volume 1, General Laws, p. 300) for a bank to levy an assessment upon the stockholders to restore any impairment that may exist in the capital structure. There is no personal liability under this assessment and the only liability is the possibility of losing the stock at a sale, in the event payment is not made. Some of appellant's cases refer to and consider this liability as distinguished from the liability created after the closing of the bank.

The case of *McClaine v. Rankin* has nothing to do with the provability under the Bankruptcy Act of a claim based upon the liability of a stockholder in a state bank. It is authority only for the application of the statute of limitations in an action against such a stockholder. The only question before the Supreme Court in *McClaine v. Rankin* which it decided was that the liability of a stockholder in a National Bank was not such a contractual obligation as brought it within the terms of a statute of limitations. We find no fault with this principle, but it does not apply in this case, as the question involved is entirely different. We concede and recognize that a different rule exists and should be applied in cases wherein the statute of limitations is involved. The *McClaine v. Rankin* case has never been followed by any court as being an authority upon any question other than the application of a state statute of limitations in an action brought against a stockholder in a National Bank, and we submit it is not an authority that answers the questions involved in this appeal. We do not believe that any of the appellant's cases support his contention that a stockholder's liability in a National Bank is statutory instead of contractual.

We believe that the cases we have cited definitely hold that the liability of a stockholder through a defunct, state or national bank, is a provable claim in bankruptcy. If the contention of the appellant is correct, then a stockholder in either such bank could never be discharged by bankruptcy from his liability as such, and the representatives of such defunct banks could never file claims against the bankrupt estates of such stockholders and share in the distribution of their estates.

If the liability is statutory it cannot ripen into a contractual obligation by the mere levy of an assessment. If the appellant is correct, then all bankruptcy courts in this country, in allowing claims based upon the liability of a bankrupt stockholder, have been in error.

Conclusion.

If the liability of a stockholder in a state bank was not to be discharged in bankruptcy, the Bankruptcy Act should so specifically state. Since it does not, then it follows in natural sequence that the liability of the bankrupt in this case for his assessment upon the stock of the Bank of San Pedro was a provable claim in bankruptcy.

Respectfully submitted,

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By JOHN G. CLOCK,
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